Personal Taxpayer Series
IR145

Inland Revenue

Low interest loans provided by employers

A guide for employees

This leaflet is for people who receive a low interest loan because of their job. It outlines the tax position from 6 April 1994. As different rules applied before 6 April 1994, ask at your local Tax Enquiry Centre or Tax Office if you need details of them.

Who is taxable?

You may have to pay tax if you

- get a low interest loan because of your job, and
- earn £8,500 or more a year (including the value of benefits and expenses) or are a director.

What loans are taxable?

In general, you are taxable on any low interest loan given to you or a relative by your employer or someone connected with your employer. A low interest loan which your employer guarantees, or finances, or helps with in other ways is also taxable.

Are any loans exempt?

Loans are exempt if the total amount outstanding stays below £5,000. Loans on commercial terms are often exempt. Further details are on pages 8 and 9.

What counts as a 'loan'?

Any form of credit counts as a loan for the purposes of the rules explained in this leaflet.

What is a low interest loan?

A loan is a low interest loan if the interest you pay on it is less than the 'official rate' of interest at that time.

What are the 'official rates' of interest?

The 'official rates' of interest are set by the Treasury. The rates vary from time

to time and broadly follow the mortgage rates offered by banks and building societies. Details of the rates are on page 12.

What is a 'relative'?

A relative means either your spouse, your or your spouse's parents, grandparents, brothers and sisters, children and grandchildren, and the spouses of any of these people.

What information will my employer give me?

For 1996-97 onwards your employer will give you the details of any low interest loans provided. You should receive the information from your employer by 6 July after the tax year ends on 5 April. Your employer gives the same information to the Inland Revenue.

What is the tax charge?

The tax charge is based on the difference between

- the interest you actually paid (if any), and
- the interest you would have paid at the appropriate 'official rate' of interest.

How is the charge calculated?

There are two alternative ways of calculating the amount of the benefit, a **normal** method and a **precise** method.

Normal method
The normal method uses

- the average of the loan, and
- the 'average official rate'

for the tax year (or part-year if the loan was not outstanding for the whole tax year).

You find the average loan by adding the maximum amount outstanding on the day before the start of the year and that on the last day of the year and dividing the total by two. If the loan was not outstanding for the whole year, you use the maximum amounts outstanding on the opening and/or closing days.

The ‘average official rate’ is the average of the various official rates that were effective during the year. The tax year starts on 6 April and ends on 5 April the following year. Details of the rates are on page 12.

This method gives a reasonably accurate result where the loan is repaid in regular sums or where the amount of the loan remains broadly unchanged over the tax year. See Example 1 on page 4.

Precise method
This method applies the appropriate ‘official rate’ to the balance of the loan on a daily basis throughout the period involved. It is more complex, but is precise. See Example 2 on page 6.

Who decides which method to use?

Generally the normal method is used unless you choose or the Inspector of Taxes chooses to use the precise method of calculation.

When your employer tells us, and you, about the value of your loan benefit at the end of the tax year, he will always use the ‘normal’ method, but you can subsequently choose to use the ‘precise’ method if you think that gives a fairer result. We can also choose to use the precise method.

Suppose I had more than one loan?

For the tax years up to 5 April 1996, if you had more than one low interest loan from the same lender you had to add them together if

- the interest (either the interest you actually paid or, if you paid no interest, the interest which you would have paid) did not qualify in whole or in part for tax relief, and

- the loans were in the same currency.

From 6 April 1996, this adding together ended, except for certain situations involving directors of close companies. Your Tax Enquiry Centre or Tax Office can tell you about this.

Under the new rules your employer will report to the Inland Revenue separately on each of your loans. This will help employers with their reporting requirements under Self Assessment.

Example 1

On 1 October 1995, an employer lends an employee, Mr Jones, £10,000 at 3% per annum. The interest is payable quarterly on 31 December, 31 March, 30 June and 30 September. Mr Jones repaid £2,000 on 1 January 1996, but then borrowed a further £4,000 on 1 July 1996. On 1 April 1997 he repays £1,000 of the second loan. None of the interest qualifies for tax relief so if the loan of £4,000 had existed in 1995-96 it would have had to have been added to the other loan. The two loans are kept separate for 1996-97.

The interest actually paid by Mr Jones to his employer in the two tax years was -

1995-96	31 December 1995		£75
	31 March 1996		£60
	Total		**£135**
1996-97	30 June 1996		£60
	30 September 1996		
		(£60+£30)	£90
	31 December 1996		
		(£60+£30)	£90
	31 March 1997		
		(£60+£30)	£90
	Total	(£240+£90)	**£330**

For the purposes of this example the 'official rate' of interest throughout both 1995-96 and 1996-97 is taken as 7.5%, and the 'average official rate' is also 7.5%.

Using the **normal** method the calculations are as follows.

1995-96 (Loan in existence for six complete months only)

Maximum balance outstanding on date loan was made	£10,000
Maximum balance outstanding on 5 April 1996	£8,000
Total	**£18,000**

Average balance: £18,000 ÷ 2 = £9,000

Interest at the 'official rate' for six complete months

$$£9{,}000 \times \frac{6}{12} \times 7.5\% = £337$$

Cont.

less interest actually paid
by Mr Jones for 1995-96 £135

Taxable benefit for 1995-96 **£202**

1996-97 First loan (in existence for 12 complete months)

Maximum balance outstanding on 5 April 1996 £8,000
Maximum balance outstanding on 5 April 1997 £8,000
Total **£16,000**

Average balance: £16,000 ÷2 = £8,000
Interest at the 'average official rate' of 7.5% for 12 months

$$£8{,}000 \times \frac{12}{12} \times 7.5\% = £600$$

less interest actually paid on this loan
by Mr Jones for 1996-97 £240

Taxable benefit **£360**

1996-97 Second loan (in existence for nine complete months)

Maximum balance outstanding on date loan was made £4,000
Maximum balance outstanding on 5 April 1997 £3,000
Total **£7,000**

Average balance: £7,000÷ 2 = £3,500
Interest at the 'official rate' for nine complete months

$$£3{,}500 \times \frac{9}{12} \times 7.5\% = £196$$

less interest actually paid on this loan
by Mr Jones for 1996-97 £90

Taxable benefit **£106**

So the total taxable benefit for 1996-97 is £466(£360+£106)

If Mr Jones is a basic rate taxpayer, the tax due
will be £466 x 24% = **£111.84.**

Example 2
The facts are the same as in Example 1.

Using the **precise** method the calculations are as follows.

1995-96
Interest on loan at the 'official rate'

£10,000 for 92 days at 7.5%	£189.04
£8,000 for 96 days at 7.5%	£157.80
Total	**£346.84**
less interest actually paid by Mr Jones for 1995-96	£135.00
Taxable benefit for 1995-96	**£211.00**

1996-97
Interest on first loan at the 'official rate'

£8,000 for 365 days at 7.5%	£600
less interest actually paid on this loan by Mr Jones for 1996-97	£240.00
Taxable benefit for 1996-97	**£360.00**

Interest on second loan at the 'official rate'

£4,000 for 279 days at 7.5%	£229.31
£3,000 for 4 days at 7.5%	£2.46
Total	**£231.77**
less interest actually paid on this loan by Mr Jones for 1996-97	**£90.00**
Taxable amount	**£141.00**

So the total taxable amount for 1996-97 is £501(£360+£141)

Again, if Mr Jones is a basic rate taxpayer, the tax due will be
£501 x 24% = **£120.24**

In these circumstances the normal method of calculating the taxable amount is more favourable to Mr Jones in both years (£111.84 compared with £120.24).

What happens if I pay interest on the loan after the end of the tax year?

If you paid the interest late you may ask your Inspector to take the late payment into account. Provided you claim within five years, ten months of the end of the year concerned, we will repay any tax overpaid.

Do I get any tax relief on the interest?

Yes, you can have tax relief for loan interest, but only if the loan is for a qualifying purpose. For example, mortgage interest relief may be available for the interest you pay on a loan to buy your own home. For 1996-97, mortgage interest relief is given at the rate of 15 per cent on the interest on the first £30,000 of a home loan. Relief on the assessable benefit does not depend on the loan being in or out of MIRAS. Contact your Tax Office for further information on which loans qualify for relief.

How do I get tax relief?

You get any tax relief due both on

- the interest you actually paid, and
- the benefit assessable.

This means you get the same tax relief as other borrowers.

Example 3

Mrs Smith has a £30,000 home loan at 2% provided by her employer. She is a higher rate taxpayer and has no other home loans. In 1996-97, the balance on the loan remained constant at £30,000 and she paid interest of £600. The 'official rate' is assumed to be 7.5% for 1996-97.

Stage1 - Calculate the taxable benefit

Interest on the loan at the 'official rate'		
£30,000 x 7.5% =	£2250	
less interest actually paid by Mrs Smith	£600	
Taxable benefit for 1996-97	**£1650**	Cont.

Stage 2 - Tax relief

Interest actually paid by Mrs Smith		
	£30,000 @ 2%	£600
Taxable benefit		£1,650
	Total	**£2,250**
Tax due on the benefit:		
£1,650 x 40% (higher rate)		£660
Less mortgage interest relief on £2,250 at 15% =		£337.50
Net tax payable		**£322.50**

The above will apply whether or not the loan is in MIRAS.

If the loan is in MIRAS, Mrs Smith will get £90 of this relief through the MIRAS scheme by making reduced payments of interest on the loan provided by her employer. The relief obtained under the Miras scheme is calculated:

Interest paid £30,000 @ 2% = £600
MIRAS = 15% x £600 = £90

Mrs Smith will be able to claim the balance of this part of the relief (£247.50) on her Self Assessment form

Are there any exemptions for small loans?

You do not pay tax on the benefit from your loans if the total of all your cheap or interest-free loans does not exceed £5,000 at any point in the tax year.

However, you should exclude from that total those loans on which the interest qualifies for tax relief, as you **do** have to pay tax on them.

Example 4
Mr Brown has a £30,000 home loan at 2% provided by his employer. He also had an interest-free season ticket loan of £2,540 at 6 April 1996, which he repaid throughout the tax year, and an interest-free personal loan of £2,000 which remained constant throughout 1996-97.

The season ticket loan of £2,540 and the personal loan of £2,000 are not loans where the interest qualifies for tax relief. When added together they do not come to more than £5,000 at any point in the tax year. So they are exempt from the benefit charge.

Interest on the home loan of £30,000 qualifies for tax relief. The loan is not exempt. The tax is calculated as in the example for Mrs Smith.

Is there any exemption for a commercial loan?

There is a separate exemption for certain 'commercial loans'. It applies both to loans made before 1996-97 and to new loans made in 1996-97 or later. The exemption applies only if all the following conditions are met

- the loan is made by an employer whose business includes the lending of money (for example, a bank, a building society or a finance house)
- the loans to employees are made on the same terms and conditions as loans made to members of the public.
- a substantial proportion of loans on those terms are made to public customers.

My loan is in a foreign currency. Does this affect the calculation of the benefit?

Lower 'official rates' of interest apply for certain loans in foreign currencies. This is because interest rates in some overseas countries are significantly lower than interest rates in the UK.

Which foreign currencies have lower 'official rates'?

The details of the currencies which have a lower 'official rate' are given on page 12.

Are there any conditions I must meet to qualify for the lower 'official rate'?

To qualify for the lower 'official rate' you must

- have a loan in another country's currency
- normally live in that country, and
- have actually lived there at some point in the tax year or in the previous five tax years.

How do I pay the tax on a cheap or interest-free loan?

Your employer will give your Tax Office details of these loans. Once the Tax Office knows you are receiving a cheap or interest-free loan, the tax will normally be collected through PAYE. The Tax Office does this by making an adjustment to your PAYE tax code for the estimated taxable benefit you are expected to receive in the year.

What happens if the estimate is wrong?

This depends on whether or not you get a tax return. If you do not get a tax return we check the adjustment to your code against the details your employer sends us after the end of the tax year. If we find that you have overpaid tax we will refund the excess. If, on the other hand, there is additional tax due because our estimate was too small, we will collect it through your PAYE code for next year.

An underpayment is most likely to occur for the first year in which you receive the loan. This is because it is unlikely that we will know about the loan in time to calculate the benefit and collect the right amount of tax. You can help keep any such underpayment to a minimum by telling your Tax Office about the loan as soon as possible.

Suppose I do get a tax return?

Using this leaflet you can decide which method (normal or precise) you want to use to work out the amount of the benefit of any low interest loan. For 1996-97 onwards, if you get a tax return, you should enter the amount of the benefit in box 1.19 of its employment pages.

You have to do this even though we will have made an adjustment to your tax code to correct an estimate of the tax due.

What will appear on my PAYE Coding Notice (Form P2)?

If the loan does not qualify for tax relief we make an adjustment to your PAYE code number. This is described as **EMPLOYERS LOAN BENEFIT** - and is our estimate of the difference between interest at the official rate and any interest you will actually pay.

Example 5
If the loan is £50,000 and you pay 4% interest which does not qualify for relief, the taxable amount is calculated as follows.

£50,000 at official rate 7.5% =	£3,750
less interest you pay at 4% =	£2,000
Taxable amount	**£1,750**

Your PAYE Coding Notice will show as a deduction:
EMPLOYERS LOAN BENEFIT 1750

If the loan qualifies for tax relief there may be two further adjustments to your code. One adjustment gives an allowance for the relief due and the second is a deduction, where appropriate, to restrict the interest relief to the appropriate rate (15% for the year 1996/97). The first adjustment is described as **BENEFICIAL LOAN INTEREST** and the second as **LOAN INTEREST RESTRICTION**.

BENEFICIAL LOAN INTEREST is the amount of notional interest that qualifies for tax relief. If your home loans exceed £30,000 the relief is restricted to notional interest on this figure. So, in the example above, if the loan is a home loan the amount of relief on the beneficial loan will look like this

$$\frac{£30,000}{£50,000} \times £1,750 = £1,050$$

LOAN INTEREST RESTRICTION. This adjustment has the effect of restricting the interest relief to 15% for 1996-97.

The calculation of this restriction varies; it is determined by the highest rate at which you pay PAYE tax. In the example above, the amount we will recover is the excessive relief given on £1,050.

If you pay tax at 20% the calculation is
£1,050 at 5% (20% - 15%) = £52.50.
A restriction of 262 is needed to collect this amount (£262 at 20% = £52.40)

If you pay tax at 24% the calculation is:
£1,050 at 9% (24% - 15%) = £94.50
This needs a restriction of 393 to collect the extra tax (£393 at 24% = £94.32).

If you pay tax at 40% the calculation is
£1,050 at 25% (40% - 15%) = £262.50
The restriction will be 656 (£656 at 40% = £262.40)

So the PAYE Coding Notice will show as a deduction:
LOAN INTEREST RESTRICTION - either 262, 393 or 656 as appropriate.

'OFFICIAL RATE' OF INTEREST (see page 1).

- Table of actual official rates.

From	To	Rate
6.11.94	5.10.95	8.0%
6.10.95	5.2.96	7.75%
6.2.96	5.6.96	7.25%
6.6.96	5.11.96	7.00%
6.11.96		6.75%

- Table of average official rates.

Year	Rate
1995-96	7.79%

- Lower official rates for certain foreign currency loans.

	From	To	Rate
Japanese Yen	6.6.94	-	3.9%
Swiss Franc	6.7.94	-	5.5%

Average official rate for qualifying Japanese Yen loans for 1995/96 is 3.9%.

Average official rate for qualifying Swiss Franc loans for 1995/96 is 5.5%.

You can get details of any later changes in official rates from your Tax Enquiry Centre or Tax Office.

What can I do if I want to comment on how my tax affairs have been dealt with?

We always value any comments on the service you have received from your Tax Enquiry Centre or Tax Office. We welcome any suggestions that could improve the service we provide for you.

If you have a complaint which the Officer in Charge of your own Tax Office cannot settle, you should contact the Inland Revenue Controller responsible for the area dealing with your tax affairs. Our leaflet IR120 'You and the Inland Revenue' tells you how to do that. It is available from any Tax Enquiry Centre or Tax Office.

If the Controller does not settle your complaint to your satisfaction you can ask the Adjudicator to look into it and recommend appropriate action.
The Adjudicator, whose services are free, is an impartial referee whose recommendations are independent. The address is:

The Adjudicator's Office
Haymarket House
28 Haymarket
London
SW1Y 4SP

Tel: 0171 930 2292
Fax: 0171 930 2298

Finally, you can ask a Member of Parliament to refer a complaint to the independent Parliamentary Commissioner for Administration, commonly known as the 'Ombudsman', whose address is

The Parliamentary Commissioner for Administration
Church House
Great Smith Street
London
SW1P 3BW

Tel: 0171 276 2130/3000.

We produce a wide range of free leaflets and booklets each designed to explain a different aspect of the tax system in plain English. Most are free.

Our IR List 'Catalogue of leaflets and booklets' gives further information about our publications, most of which you can get from any Tax Enquiry Centre or Tax Office. Their addresses are in your local phone book under 'Inland Revenue'. Most offices are open to the public from 9.30 a.m to 5 p.m., Monday to Friday, and some are also open outside these hours.

Your local library or Citizens' Advice Bureau may also have copies of our leaflets.

The Taxpayer's Charter

You are entitled to expect the Inland Revenue

To be fair

- By settling your tax affairs impartially
- By expecting you to pay only what is due under the law
- By treating everyone with equal fairness

To help you

- To get your tax affairs right
- To understand your rights and obligations
- By providing clear leaflets and forms
- By giving you information and assistance at our enquiry offices
- By being courteous at all times

To provide an efficient service

- By settling your tax affairs promptly and accurately
- By keeping your private affairs strictly confidential
- By using the information you give us only as allowed by the law
- By keeping to a minimum your costs of complying with the law
- By keeping our costs down

To be accountable for what we do

- By setting standards for ourselves and publishing how well we live up to them

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If you are not satisfied

- We will tell you exactly how to complain
- You can ask for your tax affairs to be looked at again
- You can appeal to an independent tribunal
- Your MP can refer your complaint to the Ombudsman

In return, we need you

- To be honest
- To give us accurate information
- To pay your tax on time

These notes are for guidance only and reflect the tax position at the time of writing. They do not affect any right of appeal.

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